

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KELLEY  
(USPS-T-30) TO INTERROGATORY OF VALPAK (VP/USPS-T30-32)  
(July 28, 2006)

The United States Postal Service hereby provides the response of witness Kelley to the following interrogatory of ValPak, Inc., filed on July 14, 2006: VP/USPS-T30-32.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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Chief Counsel, Ratemaking

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July 28, 2006

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**VP/USPS-T30-32.**

Please refer to your testimony (USPS-T-30), page 10, line 20, through page 14, line 17, and to your response to VP/USPS-T30-17(b), which sets out your estimate of \$165 million for the base year delivery costs for DALs.

a. Please confirm that your testimony in this docket (USPS-T-30) discusses Detached Address Labels ("DALs") only at page 10, line 15, through page 14, line 17.

b. Please confirm that your testimony (at p. 10, l. 20 to p. 11, l. 4) explains that the In-Office Cost System attributes the costs of the DALs to letters, while the Revenue Pieces and Weight System attributes the revenue from these DALs to flats.

c. Your testimony at page 11, lines 4-5, states that this "different treatment of DAL mailings by these systems complicates the methods used to derive unit delivery costs for ECR Saturation rate categories."

(i) Please confirm that your testimony does not describe the way in which the Postal Service has historically attributed the costs associated with delivering DALs to letters rather than flats as an error, mistake, oversight, or by way of some other similar description. If you do not confirm, please state where this is described in your testimony.

(ii) In your opinion, was the way in which the Postal Service historically attributed the costs associated with delivering DALs an error or mistake or oversight resulting in overattribution of costs to ECR Saturation letters and underattribution to ECR Saturation flats (that then led to the undercharging of ECR Saturation flats, and the overcharging of ECR Saturation letters in prior dockets)?

d. Your testimony at page 11, lines 6-7, states that in "Docket No. R2005-1, all delivery costs (segments, 6, 7, and 10) associated with ECR Saturation DALs were transferred to ECR Saturation Flats."

(i) Please confirm that the cost transfer you reference had no effect on the rates requested by the Postal Service for ECR Saturation letters and flats, and that the historic overcharging of ECR Saturation letters, and the undercharging of ECR Saturation letters continued in Docket No. R2005-1, as pre-Docket No. R2005-1 rates were increased by the same percentage. If you do not confirm, please explain why.

(ii) In your opinion, did the Postal Service's decision in Docket No. R2005-1 to increase rates for ECR Saturation letters and flats by the same percentage, without making any adjustment for the costing mistake that had been identified, perpetuate rates based on historically inaccurate cost attribution and result in unfairness to ECR Saturation letters?

e. (i) Please confirm that your testimony (USPS-T-16) in Docket No. R2005-1 contains only a chart at page 6 (revised 6/17/05) and provides no narrative discussion whatsoever of the erroneous overattribution of costs to ECR Saturation letters and underattribution of costs to ECR Saturation flats (and consequent overcharging of ECR Saturation letters and undercharging of ECR Saturation flats).

(ii) Please confirm that nowhere in your or other Postal Service testimony submitted to the Commission in Docket No. R2005-1 was the historic

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overcharging of ECR Saturation letters to the benefit of ECR Saturation flats relating to DALs described as being the result of a Postal Service mistake, error, oversight, or other similar description.

f. Please identify the date and circumstances of first time that you, or anyone in the Postal Service to your knowledge, became aware of this error discussed above in part d dealing with the method of attributing the costs of DALs to ECR Saturation letters.

g. Please explain whether the \$165 million estimate in your response to VP/USPST30-17(b) is an estimate of the extent to which ECR Saturation letter costs would have been overstated and ECR Saturation letter costs would be understated in the Base Year, if the DAL cost/revenue mismatch had not been identified and adjusted for by you in USPS-T-30.

h. Please confirm that if the \$165 million Base Year delivery cost estimate in your response to VP/USPS-T30-17(b) is divided by the number of ECR Saturation letters in the Base Year, that it would reveal the unit overstatement of costs for ECR Saturation letters that occurred in the Base Year. Please explain any failure to confirm.

Response

a. Confirmed.

b. Not confirmed. The IOCS assigns DAL costs to their host-pieces. Quoting from page 10 of my testimony, "the In-Office Cost System (IOCS) distributes tallies from DALs to their host pieces". RPW considers a DAL mailing (DAL and host piece) as one piece of mail with the same shape as its host piece.

Therefore the revenue and volume of DAL mailings are included with their host pieces – either flats or parcels.

c. (i) My testimony (page 11 line 6) only discusses the treatment of DAL costs from the instant docket and the previous docket (Docket No R2005-1). It does not include a discussion of the historical treatment of DALs in deriving delivery costs.

(ii). No, I do not believe that the Postal Service necessarily overestimated the unit delivery costs for ECR Saturation letters in previous unit delivery cost

Response of Postal Service Witness Kelley to Interrogatories Posed by Valpak Direct Marketing Systems, Inc and Valpak Dealers' Association, Inc models. Before Docket No R2005-1, the Postal Service utilized a considerably different methodology to derive unit delivery costs. The previous methodology made more extensive use of RPW volumes to distribute portions of segments 7 and 10 costs to shape. As a result, the costs distributed based on RPW volumes were not incorrectly attributed to ECR Saturation letters, since DAL volume is not included in RPW Saturation letter volume. In addition, my understanding is that segment 6 costs have historically attributed DAL costs to flats.

A useful comparison of the two methods can be found in Docket No. R2005-1, in which my testimony included the unit delivery costs from the two methods. The current methodology, which explicitly transfers DAL costs, was employed in USPS-LR-K-67 (USPS version), and the previous methodology, which implicitly transfers DAL costs by using RPW volumes rather than CCS volumes, was used in USPS-LR-K-101 (PRC version). The table below shows the R2005-1 test year unit delivery costs from each methodology.

<b>ECR Saturation</b>	<b>TY06 UDC USPS-LR-K-67 (Cents)</b>	<b>TY06 UDC USPS-LR-K-101 (Cents)</b>	<b>Difference (USPS-PRC) (Cents)</b>	<b>Volume</b>	<b>Cost (Difference x Volume (000))</b>
Letters	4.137	4.003	0.134	4,229,835	\$5,659

The difference in the unit delivery cost for ECR Saturation letters is only 0.134 cent from the two versions. This difference translates into a \$5.7 million difference in ECR Saturation letter delivery costs between the two methods.

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Even this small difference cannot be solely attributed to an incorrect allocation of DAL costs using the previous methodology. From this direct comparison of unit delivery costs for ECR Saturation letters using the two methods, I cannot conclude that the Postal Service "historically" disproportionately allocated a material amount of costs to ECR Saturation letters due to the mistreatment of DAL costs.

d. (i) Not confirmed. I don't know. I had no role in setting rates in the previous docket.

(ii). I have no opinion on rate design issues. As explained in part c (ii), however, I do not necessarily accept your assertion that the unit delivery costs for ECR Saturation letter costs have historically been overstated by a material amount due to the mistreatment of DAL costs.

e. (i) I confirm that my direct testimony in Docket R2005-1 does not contain any discussion, other than in a footnote on page six, about the treatment of DAL costs in Docket R2005-1 or any previous docket.

(ii). Confirmed. I don't believe that the Postal Service has necessarily committed such a mistake, error, or oversight in its previous derivations of unit delivery costs.

f. I do not know the specific date. The change in the methodology to use CCS volumes to distribute subclass costs to shape was the impetus to explicitly shift segments 7 and 10 DA costs, as was done implicitly with the use of RPW for distribution in previous dockets. CCS counts DALs as letters so to distribute subclass costs to shape based on letter volumes that include DALs would result

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in a higher proportion of segments 7 and 10 costs being attributed to ECR Saturation letters. The change in methodology required the change in the treatment of DAL costs, as without the transfer, the unit delivery costs for ECR Saturation letters would be between two and one-half and three cents higher (depending on which case is examined) as the table below indicates.

<b>ECR Saturation</b>	<b>TY UDC (LR-L-67) Docket No. R2006-1 (Cents)</b>	<b>TY UDC (LR-K-67) Docket No. R2005-1 (Cents)</b>
<b>Letters (with Segments 7 and 10 DAL costs included)</b>	6.191	6.665
<b>Letters (with Segments 7 and 10 DAL costs shifted to flats)</b>	3.205	4.137
<b>Difference</b>	2.986	2.527

g. I am not sure why you have posed this question in conjunction with questions about what has been done in previous dockets. I agree that \$165 million is an estimate of the amount in the current case by ECR Saturation letter costs would have been overstated and ECR Saturation flat costs would have been understated if all of the costs identified with DALs had erroneously been associated with letters as opposed to flats, but that amount has no necessary relationship with the methodology used prior to Docket No. R2005-1.

h. Not confirmed. The procedure you describe would not reveal the overstatement in estimated unit letter costs "that occurred in the Base Year." No overstatement of estimated unit letter costs occurred in the Base Year. Instead, the procedure you describe relates to the overstatement in estimated unit letter

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costs that *would* have occurred in the Base Year, if all of the costs estimated to be associated with DALs had erroneously been associated with letters instead of flats.

## CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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